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CONDENSED REPORT OF EXAMINATION

THE NATIONAL TOOL COMPANY — CLEVELAND, OHIO

December 31, 1939

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To the Stockholders of The National Tool Co.

Financial Statements of The National Tool Company are submitted herewith.

We closed the year with a net loss of $5,100.65 as compared with a loss of $145,246.31 in the year 1938. During the last five months of 1939 we earned a profit of over $36,000.00 and succeeded in wiping out all but $5,100.00 of a loss that had been incurred, due to low volume of sales in the first 7 months. We are happy to advise you that this profit showing is continuing and we are confident that the first quarter of 1940 will show a favorable result.

During the year the notes payable were reduced by an amount of $26,000.00. Capital Expenditures for the 12 months ended December 31, 1939 amounted to $17,699.02. Depreciation charged off $23,553.04. Taxes accrued during the year $28,175.19 and total payroll $434,099.52.

Thanks to our continuing profitable operation we are improving our current capital and cash position and the lack of working capital is no longer a serious problem.

Our inventories increased by the amount of only $13,130.04 over the previous year end, this despite the fact that our volume of sales during the last six months of 1939 exceeded the entire year's sales of 1938.

We have continued to improve our organization, operating methods and personnel and are looking forward with confidence to a profitable 1940.

Your Board of Directors have authorized the transferring from capital surplus an amount, sufficient to close out the accumulated deficit to December 31, 1939. This was done so that the Company may be placed in a position to pay dividends on its common stock as soon as conditions warrant.

February, 1939.

A. J. BRANDT,
President

BALANCE

THE NATIONAL T

December 3

ASSETS

CURRENT ASSETS			
Cash:			
Demand deposits	$ 16,901.37		
Office working fund	308.70	$ 17,210.07	
Accounts receivable:			
Trade accounts	$ 93,594.33		
Less reserve	1,000.00	92,594.33	
Inventories-at lower of estimated cost or market:			
Finished products:			
Cutting tools	$ 22,642.32		
Machine	8,500.00	$31,142.32	
Work in process		58,309.67	
Raw materials:			
Steel stock	$ 28,845.98		
Forgings	17,145.60	45,991.58	
Manufacturing supplies		12,957.59	
Scrap steel		770.20	
		$149,171.36	
Less reserve for slow-moving and obsolete items.		9,167.33	140,004.03 $249,808.43
INVESTMENTS AND OTHER ASSETS			
Miscellaneous deposits, receivables, etc.:			
Trade accounts receivable not current	$ 8,062.14		
Less reserve	3,145.78		
	$ 4,916.36		
Other receivables, deposits, etc.	5,944.51	$ 10,860.87	
Investments:			
L. G. S. Tools, Inc.—500 shares preferred stock and 5,000 shares common stock at cost	$5,000.00		
S. A. Andre Citroen—3¼% debentures and profit sharing certificates—approximate market price	246.85		
Sundry securities at nominal amounts	3.00	5,249.85	
Accounts with officers and employees		1,247.99	
Cash surrender value of life insurance	$ 3,354.96		
Less policy loan and accrued interest	2,598.82	756.14	18,114.85
PROPERTY, PLANT AND EQUIPMENT—			
Cost, less reserves for depreciation			
Land	$ 39,103.98		
Buildings	$174,502.49		
Machinery, equipment, etc.	281,472.30	$455,974.79	
Less reserves for depreciation		227,354.57	228,620.22
Appropriations in process		17,799.63	285,523.83
GOOD WILL, PATENTS, ETC.—nominal amount			1.00
DEFERRED CHARGES			
Deferred tool expense:			
Regular tools	$ 8,980.57		
Rock bit tools	6,314.61	$ 15,295.18	
Unamortized debenture discount and expense		7,914.17	
Deferred development expense		5,954.56	
Unexpired insurance premiums		3,211.56	
Deferred financing expense		1,170.70	
Prepaid taxes, interest, etc.		900.86	34,447.03
			$587.895.14

The National Tool Company,
Cleveland, Ohio.

We have examined the balance sheet of The National Tool Company as of December 31, 1939, and the statements of profit and loss and surplus for the year then ended, have reviewed the system of internal control and the accounting procedures of the Company and, without making a detailed audit of the transactions, have examined or tested accounting records of the Company and other supporting evidence, by methods and to the extent we deemed appropriate.

Statements covering all trade accounts receivable balances at December 31, 1939, were stamped with a request the we be notified of any differences and were mailed under our supervision. Differences reported to us have been of a minor nature. Inventories of finished goods and raw materials are included as shown by continuous records of the Company, no complete physical inventory having been taken of these items since December 31, 1938. Quantities on hand at December 31, 1939, as shown by tests made by us, were in agreement with the continuous records. Inventories of work in process, manufacturing supplies and scrap steel are stated on the basis of counts made by employees of the Company at the end of December, 1939, at which time we were present and observed the procedure followed. Raw steel stock, work in process and finished cutting tools were priced at standard costs which approximated actual costs during the periods in which the inventories were acquired. Inventories of forgings and manufacturing supplies were priced at cost. Special worm gear generating machine manufactured for sale and scrap steel were priced at estimated market, which for the machine, was less than cost. The reserve for slow-moving and obsolete inventories was provided in prior periods.

Property, plant and equipment are stated at cost to predecessor company, plus subsequent additions at cost and less reserve for depreciation to December 31, 1939. Deferred charges include items to be absorbed in future operations. Tool costs are charged to operations at the rate of one-twelfth of the deferred balance each month, except for rock bit tools which together with the deferred development expense of rock bit cutters, are amortized at specified amounts for each cutter or part shipped.

Convertible 6% sinking fund debentures are convertible into common stock of the Company at the rate of 400 shares of stock for each $1,000.00 principal amount of debentures. Stock purchase warrants attached to each $1,000.00 principal amount of debentures carry the right to purchase, as a unit, 50 shares of common stock at $5.00 a share. During 1939, 800 shares of common stock were issued upon the conversion of $2,000.00 principal amount of debentures.

In a meeting on February 9,1940, the Board of Directors of the Company authorized the transfer as of December 39, 1939, of a sufficient amount of capital surplus to eliminate earned surplus (deficit) balance as of that date. This transfer has been given effect to in the accompanying statements.

In our opinion, the accompanying balance sheet and related statements of profit and loss and surplus present fairly the position of The National Tool Company at December 31, 1939, and the results of its operations for the year, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

ERNST & ERNST

Certified Public Accountants

Cleveland, Ohio
February 16, 1940

SHEET

OOL COMPANY

1, 1939

LIABILITIES, CAPITAL STOCK AND SURPLUS

CURRENT LIABILITIES			
Notes payable:			
To bank	$ 7,500.00		
To vendor	1,500.00	$ 9,000.00	
Accounts payable:			
Trade accounts	$ 83,329.59		
Wages and commissions	24,824.05		
Pay roll taxes	8,339.31	116,492.95	
Accrued:			
Interest	$ 4,974.50		
Local taxes	3,750.00		
Federal capital stock tax	1,400.00		
Royalties, water rent, etc.	531.36	10,655.86	$136,148.81
FUNDED DEBT			
Convertible 6% sinking fund debentures (with warrants attached) maturing August 1, 1942			198,000.00
PAYMENTS ON STOCK SUBSCRIPTIONS—EMPLOYEES			283.76
RESERVE			
For contingencies			2,835.00
CAPITAL STOCK AND SURPLUS			
Capital stock—Note A:			
Common stock, par value $1.00 per share:			
Authorized 600,000 shares:			
Outstanding 174,861 shares	$174,861.00		
Reserved for exchange of preferred and common shares of predecessor company 1,442 shares	1,442.00		
176,303 shares		$176,303.00	
Capital surplus		74,324.57	250,627.57

Note A—In addition to capital stock set forth as outstanding or reserved in the above statement, the Company has reserved at December 31, 1939, 149,590 shares for the following purposes:

Reserved for issuance to underwriter at $2.00 a share	29,370 shares
Optioned to underwriters under certain conditions at $2.50 a share	27,000 shares
Optioned to A. J. Brandt at $2.50 a share	4,000 shares
Reserved for conversion of debentures	79,200 shares
Reserved for conversion of stock warrants attached to debentures	9,900 shares
Reserved for issuance to employees under stock purchase agreements	120 shares
	149,590 shares

Note B—At December 31, 1939, the Company was liable for payment of attorneys fees in the amount of $1,200.00, such payment being contingent upon receipt by the Company of proceeds from the sale of common stock to underwriters.

$587,895.14

SURPLUS-DEFICIT ACCOUNTS

THE NATIONAL TOOL COMPANY

Year ended December 31, 1939

CAPITAL SURPLUS

Balance at January 1, 1939		$202,092.20
Add:		
Premium on 10,198 shares of common stock issued to employees at $2.50 a share under stock subscription plans	$ 15,297.00	
Premium on 12,985 shares of common stock sold to underwriters at $2.00 a share	12,985.00	
Premium on 800 shares of common stock issued on conversion of debentures in the principal amount of $2,000.00	1,200.00	
Premium on 80 shares sold to an employee at $2.50 a share	120.00	
Unused portion of reserve provided by predecessor company at July 31, 1937, for federal income taxes for the seven months ended at that date	1,235.93	30,837.93
		$232,930.13
Deduct:		
Expenses incurred in connection with the qualifying and issuing of shares sold to underwriters	$ 3,585.09	
Amount transferred to earned surplus (deficit) as of December 31, 1939, by authorization of the Board of Directors	155,020.47	158,605.56
BALANCE DECEMBER 31, 1939		$ 74,324.57

EARNED SURPLUS (DEFICIT)

Balance at January 1, 1939		$149,919.82
Add:		
Net loss for the year ended December 31, 1939		5,100.65
		$155,020.47
Deduct:		
Amount transferred from capital surplus as of December 31, 1939, by authorization of the Board of Directors		155,020.47
BALANCE DECEMBER 31, 1939		$ -o-

PROFIT AND LOSS STATEMENT

THE NATIONAL TOOL COMPANY

Year ended December 31, 1939

Net sales		$741,971.20
Cost of products sold		597,019.10
GROSS PROFIT		$144,952.10
Expenses:		
Selling	$106,669.83	
Administrative	41,194.03	147,863.86
OPERATING LOSS		$ 2,911.76
Other deductions:		
Interest on funded debt	$ 11,968.17	
Interest on notes and accounts	1,232.12	
Amortization of bond discount and expense	3,063.48	
Bad debts charged off ($497.64) and sundry other deductions	732.87	16,996.64
		$ 19,908.40
Other income:		
Profit on sale of capital assets	$ 7,862.09	
Net proceeds from life insurance policy on former officer, deceased during year	4,494.18	
Cash surrender value on policy insuring life of officer, less premium expense	1,839.57	
Sundry other income	611.91	14,807.75
NET LOSS		$ 5,100.65

Provision for depreciation included above—$23,553.04